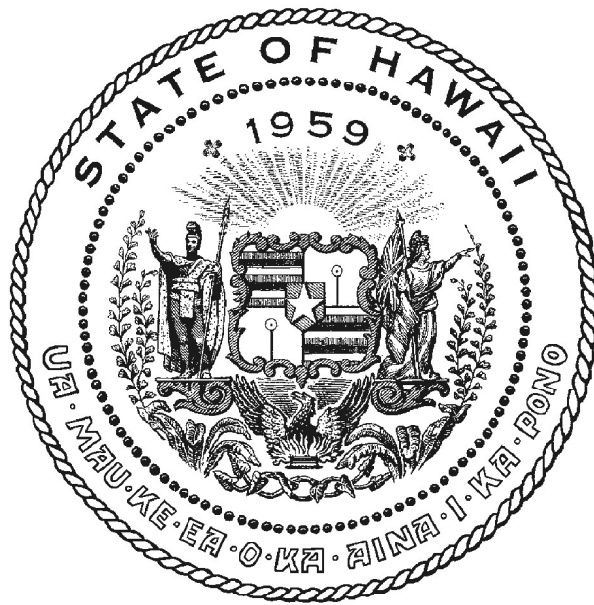


DEPARTMENT OF TAXATION

STATE OF HAWAII



ANNUAL REPORT

1998 - 1999

(Revised February 2000)

October 25, 1999

The Honorable Benjamin J. Cayetano
Governor
State of Hawaii

Dear Governor Cayetano:

It is my privilege to present to you this annual report summarizing the activities of the Department of Taxation for the fiscal year ending June 30, 1999.

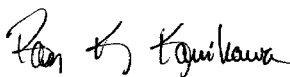
As we face the year 2000, the department strives to keep abreast of fast-paced technological change. All hardware and software potentially affected by "Y2K" have been scrutinized, remedied, and a contingency plan developed. Following the success of electronic funds transfer (EFT), the department has launched electronic filing (ELF) for withholding taxes, thereby enabling payroll service providers an efficient means of remitting taxes due.

Considerable effort was directed toward finalizing the State's first performance-based technology contract for developing the department's Integrated Tax Information Management System (ITIMS). This performance-based contract will be benefits-funded; i.e., the contractor only will get paid from increased revenue attributable to ITIMS and if performance standards are met. ITIMS will provide automated tools to increase effectiveness and productivity which will improve services to the public and meet increasing service demands without sacrificing fair and equal treatment to taxpayers. With this new system, Hawaii Taxpayers can expect faster refunds, quicker responses to inquiries on tax returns and accounts, and speedier tax problem resolutions.

Assuring compliance with tax laws remains our principal avenue of public service. Many past initiatives, such as nonfiler identification and follow up, informational and educational activities, special audit projects, and taxpayer advocacy, continue to be productive. The department has aggressively expanded its reliance on out-sourcing for delinquent tax collection by contracting with a mainland collection agency in addition to using local ones. The approach has proven extremely cost-effective. Through high-profile criminal convictions, the department continues to emphasize the civic duty of every citizen and business to pay one's fair share.

The department lent its usual support to the 1999 Legislature by providing revenue estimates and tax policy advice. Following upon your income tax reductions of last year, your economic stimulus initiatives that were also voiced by the 1997 Economic Revitalization Task Force were more fully realized by the passage of measures to ease the general excise tax burden on local businesses; these included provisions to gradually reduce the insidious effects of pyramiding of the general excise tax and to exempt services exported outside Hawaii while taxing imported services. The department continues to articulate its technical interpretations of enacted measures through announcements, tax information releases, rules, workshops, seminars, and other means.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Ray K. Kamikawa".

RAY K. KAMIKAWA
Director of Taxation

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THE YEAR IN REVIEW

TAX SERVICES AND PROCESSING DIVISION

The objectives of the Tax Services and Processing Division are achieved through the activities of its three branches--Document Processing, Revenue Accounting, and Taxpayer Services.

The major objective of the Document Processing Branch is to efficiently process all tax returns and documents. This branch processed over 97,000 pounds or 2.6 million pieces of incoming mail, including 1.4 million payment transactions. Collections through the electronic funds transfer (EFT) program exceeded \$1.6 billion. A pilot program for electronic filing (ELF) of periodic withholding tax returns was implemented in February 1999.

The Revenue Accounting Branch maintains accurate accounting records and prepares timely accounting reports. This was achieved through controlling and accounting for all tax collections, adjustments and refunds.

Providing service and disseminating information and forms to the taxpayers are the primary objectives of the Taxpayer Services Branch. Among the continuing initiatives of this branch are the issuance of quarterly newsletters and Tax Facts which provides relevant information on tax topics of general interest, informational workshops for tax practitioners, practitioners' forums, public service announcements through radio and television, etc.

Dissemination of information and forms continues through maintenance of a website, forms by fax and the third annual updated CD-ROM. The updated version of the CD-ROM allowed taxpayers to input data onto the commonly used forms and print the completed information on their printers. Basic and commonly used forms from the Department of Commerce and Consumer Affairs and the Department of Labor and Industrial Relations also were included in the CD-ROM.

Tax clearance processing was made simpler by allowing taxpayers to fill in the application on the CD-ROM or at our website and to download the completed form which could then be faxed or mailed in. In cooperation with the Internal Revenue Service, the department now issues temporary Federal Employer Identification Numbers (FEIN) to new businesses registering at the Oahu Tax Office.

COMPLIANCE DIVISION

The primary objective of the Compliance Division, comprised of the audit and collection branches, continues to be maximized taxpayer compliance with Hawaii tax laws. Programs established to meet voluntary compliance and a self-assessment environment are: (1) returns processing, exception handling; (2) auditing; (3) collection; and (4) taxpayer services and information dissemination.

Exception Handling/Error Correction

The division performed exception handling of returns and other tax documents processed by the department. During the fiscal year, 947,098 net income tax documents were processed. Errors were detected on 11.9% of these documents and on-line errors were reviewed and corrected within the established clock periods.

Exception handling was also done for returns and documents of general excise, use, transient accommodations and other miscellaneous taxes. These returns represent the largest volume of returns processed and include periodic (monthly, quarterly, and semiannual) and annual tax returns.

Auditing

To support self-assessment and voluntary compliance, the audit branches performed 6,586 audits during FY 1999.

	<u>Office Audits</u>		<u>Field Audits</u>	
	<u># of Audits</u>	<u>Assessments</u>	<u># of Audits</u>	<u>Assessments</u>
Oahu	3,850	\$ 7,809,660	297	\$ 55,172,337
Maui	371	504,410	45	857,704
Hawaii	1,253	1,145,953	39	2,909,824
Kauai	623	962,195	15	745,502
Total FY 1999	6,097	\$ 10,422,218	489	\$ 59,685,367
Total FY 1998	6,126	8,669,150	403	74,610,601
Difference	-29	\$ 1,753,068	86	\$ -14,925,234

Office Audit operations closed 6,097 cases with assessments totaling \$10.4 million, which is \$1.8 million more than the previous fiscal year. Field audit operations closed 489 cases with assessments totaling \$59.7 million, \$14.9 million less than the previous fiscal year.

The dollar value of assessments per work hour done by Oahu's field audit operations decreased from \$2,766 in the previous fiscal year to \$1,897 in FY 1999. This was probably a result of the increasing complexity and size of the issues audited, which often require greater experience and sophistication in our audit staff.

Criminal Tax Unit

During the fiscal year, indictments were returned against seven individuals and two corporations. Complaints were also filed against two corporations and two individuals. Of the four complaints three were from Oahu and one from Maui, and all nine indictments were from Oahu. These indictments and complaints resulted in tax assessments of \$1.1 million, almost unchanged from the previous year.

Taxpayer Assistance Provided

The importance of maintaining taxpayer willingness to accurately and voluntarily comply with tax laws will continue to be emphasized, as mentioned in the department's Mission Statement. This was accomplished by providing taxpayer assistance through telephone calls, over-the-counter questions, and correspondences.

Neighbor island district offices also provided assistance in nearly 180,000 instances. They also continued to provide speakers for tax preparation and other workshops, such as Tax Counseling for the Elderly, University Extension Service, Small Business Administration and other outreach programs.

Special Projects - Audit Branch

Each audit section was assigned special projects to research and advise taxpayers of their responsibilities to various tax laws. Through these projects, the department made assessments of over \$11.0 million. Listed below are the special projects assigned by the different offices.

Oahu District - Office Audit Branch

- ▶ Schedule C Project
- ▶ ROTC Instructors Project
- ▶ COLA - Postal Workers Project
- ▶ Real Estate License project

Oahu District Office - Field Audit Branch

- ▶ Mainland Audit Trips
- ▶ Federal Contractors Project
- ▶ BDC (Business Development Corporation) Project
- ▶ PSC (Public Service Company) Project
- ▶ Self Assessment Project - PSC and Use Tax
- ▶ Miscellaneous Tax Project
- ▶ Air Cargo & Package Express Service Companies/Freight Forwarders Compliance Project

Maui District Office

- ▶ Rental Project
- ▶ Real Estate Project

Hawaii District Office

- ▶ 1994 Schedule C Project
- ▶ Real Estate Licensee Compliance Project
- ▶ PSC Compliance Project
- ▶ Air Cargo & Freight Forwarders Compliance Project
- ▶ Outside Public Contact (OPC) Compliance Project
- ▶ ROTC Instructors Project
- ▶ BDC Project

Kauai District Office

- ▶ Schedule C
- ▶ Real Estate Licensees
- ▶ Imported Aircraft
- ▶ Public Service Company
- ▶ Unlicensed Construction Contractors
- ▶ ROTC Instructors
- ▶ Outside Public Contact (OPC)

Delinquent Tax Collections

Continuing efforts are being made to pursue delinquent taxpayers and non-filers. Through updated computer technology and a joint effort with the Internal Revenue Service, the department is better able to identify these taxpayers. Along with operational changes, the collection program achieved a \$3.9 million increase in statewide total outstanding delinquent taxes for FY 1999. The resulting \$222.3 million total represents a 1.8% increase over the previous year. A substantial 20.3% increase in cash collections to \$99.8 million, reversed two years of declining revenues from delinquent taxes in fiscal years 1997 and 1998. Results of collections efforts are listed below:

<u>Measurement</u>	<u>FY 1999</u>	<u>FY1998</u>	<u>Difference</u>	<u>% change</u>
Total Delinquent Balance (\$ million)	\$ 222.3	\$ 218.5	\$ 3.9	1.8%
Cash Collected (\$ million)	\$ 99.8	\$ 83.0	\$ 16.9	20.3%
Payment Plans	2,053	1,949	104	5.3%
Liens Filed	3,023	2,256	767	34.0%
Levis Served	6,254	9,933	-3,679	-37.0%
Uncollectible written off (\$ million)	\$ 8.3	\$ 10.0	\$ -1.7	-17.1%

NOTE: Due to rounding detail may not add to totals.

Special Projects - Collection Branch

Real Estate Relicensing - This project was initiated in FY 1997 and was continued throughout FY 1999. It utilized data on real estate brokers and sales persons obtained from the data files of the Department of Commerce and Consumer Affairs (DCCA) to identify possible non-filers. Over the two-year period, this project has resulted in over \$8.0 million in tax liabilities being filed and over \$4.7 million in delinquent taxes, penalties and interest being collected.

Private Collection Agency - During the past three fiscal years, the Oahu Collection Branch has referred over 8,000 delinquent accounts to three local collection agencies, the Attorney General's Office and one mainland collection agency. The amount collected during the three-year period is over \$1.2 million in delinquent taxes, penalties and interest being collected. Currently, the ongoing mainland collection agency project has collected over \$215,000 in delinquency payments.

Cost Recovery Fees - In March 1998, the various collection units began to collect cost recovery fees for a variety of collection actions such as delinquent account processing, lien filing, lien releases, levies, etc. To date, the amount collected for these types of fees amounted to over \$59,100.

STAFF OFFICES

Administrative Services Office

Fiscal Office

The Administrative Services Office submitted the fiscal biennium budget for fiscal years 2000 and 2001 to the 1999 Legislature. For fiscal years 2000 and 2001, the Department was appropriated \$16.3 million and \$16.6 million.

In carrying out its duties, the Department of Taxation incurred operating expenditures of \$16.2 million for fiscal year 1999. With total taxes collected and administered by the department increasing by \$33 million and expenditures reduced from \$16.9 to \$16.2 million, the cost of collecting \$100 of taxes decreased from 48 cents in fiscal year 1998 to 46 cents in fiscal year 1999.

Personnel Management

Department of Taxation was authorized 343 positions for the fiscal year. Employees were geographically distributed as follows: Oahu, 275; Hawaii, 29; Maui/Molokai, 25; and Kauai, 14.

Personnel actions within the department included 11 new civil service hires, 7 retirements, 106 temporary hires, and 11 resignations. Other personnel actions included the resignation or termination of 100 temporary employees hired for the tax season.

STAFFING PATTERN

(Number of Authorized Permanent Positions)

<u>By Organization/Operating Program</u>	<u>1999</u>	<u>1998</u>	<u>1997</u>	<u>1996</u>
Headquarter Administration	40	40	49	50
Tax Services and Processing Division	99	99	90	90
Audit Division	111	111	112	114
Collection Division	93	93	93	95
TOTAL	343	343	344	349

Employees participated in various training programs to expand their professional skills, thus increasing their efficiency and effectiveness in performing their duties. Computer software use and leadership training were among the programs attended by department employees.

Rules Office

The Administrative Rules Office is the department's advisory arm to the director on tax policy. In addition to drafting and commenting on tax proposals, the Rules Office develops tax policy in rules, tax information releases, announcements, directives, and other publications.

For the 1999 legislative session, the Rules Office drafted 14 administration-sponsored tax proposals, prepared 324 testimonies on 313 bills and 11 resolutions, and submitted comments to the Governor's Office on 24 acts passed by the legislature (one of the acts was vetoed by the Governor). Members of the Rules Office also testified at legislative committee hearings on behalf of the Director of Taxation.

The Rules Office prepared 32 Governor's letters, 35 Director's correspondences, 26 announcements, four rules, and six tax information releases. The office also reviewed legislative proposals and rules of other agencies, provided training for department employees and speakers at several tax forums for practitioners.

Information Technology Services Office

The Information Technology Services Office (ITSO) is responsible for the development, modification, and maintenance of the department's computerized tax systems and components. With the year 2000 (Y2K) on the horizon, ITSO has focused much of its efforts and resources to ensure that all department computer systems and resources are Y2K compliant.

Y2K problems affecting both the General Excise, Withholding, Transient Accommodations, and Rental Vehicle/Tour Vehicle Surcharge Tax (GEW/TAT) system and the Comprehensive Net Income Tax (CNIT) system have been identified and remediated. All upgrades and replacement hardware and software have been procured for non-Y2K compliant computer components for the department's local area network (LAN) and wide area network (WAN). Implementation of Y2K remediation for all systems and components is expected to be completed by the end of August 1999. A Y2K contingency plan is being developed in the event that the Department experiences problems with the transition to the year 2000.

The Department is working on finalizing a benefits-based procurement contract for a new Integrated Tax Information Management System (ITIMS) that will replace the existing GEW/TAT and CNIT systems. In preparation for the ITIMS project the department has been working on numerous activities, such as: completing the basic network infrastructure, reconfiguring work environments, forming various project teams, and establishing a funding mechanism.

The Systems Networking staff has upgraded the LAN for each district with CD-ROM towers, faster servers, and switches. The CD towers will allow every user access to the department's reference CD's. The new servers and switches will be able to support the additional processing speed and bandwidth requirements for ITIMS. The Systems Networking staff continues to maintain a help desk for troubleshooting problems and train staff on topics such as: PC fundamentals, LAN orientation, Windows 3.1 and 95, GroupWise, the Internet, and other applications the department uses.

The Systems Development staff continues to enhance the GEW/TAT system. Electronic Filing (ELF) has been implemented for withholding taxes. This allows authorized payroll providers to file periodic returns electronically for taxpayers who pay via Electronic Funds Transfer (EFT). ELF benefits the taxpayer by

providing a more efficient method of filing and the department by reducing the amount of data entry work. An enhancement was implemented to facilitate the online reapplication of taxpayer information. This enhancement greatly reduces previous limitations and program complexity, decreasing the amount of time needed should future modifications involving reapplications be necessary. Also enhanced was increasing the reporting accuracy for the large volume of EFT payments to more precisely reflect the island district origin of EFT payments. This has aided the Tax Research and Planning Office to better monitor, report, and forecast ongoing changes in the State's economy.

ITSO continued performing liaison tasks for the CNIT system. The CNIT system was enhanced to accommodate the legislated decrease in the individual income tax for 1999. Other system enhancements included: modifying the "Notice of Delinquency" to print the interest only if the return due date has passed; suppressing the printing of the second notice of delinquency to streamline cost; changing the wording of the final notice of delinquency to be friendlier; modifying the Underpayment Of Estimated Tax letter (CNIT-15L) to remove the spouse's name when the taxpayer files married filing separately; modifying the Adjustment Letter (CNIT-09L) so that taxpayers can use it to make payments; modifying the tolerance level for the underpayment of the estimated tax penalty; allowing Fiduciary Income Tax Return (Form N-40) filers to request tax return packets for the next year's filing, thus eliminating the previous manual process and providing convenience to taxpayers; and using the Hawaii Net Income Tax Bill (Form N-126) to create a basic taxpayer account allowing loose checks to be processed immediately rather than waiting for the tax return to be filed.

Tax Research & Planning Office

The Tax Research & Planning Office (TR&P) reviews and analyzes the effect of legislative tax proposals, publishes statistics on income tax and tax credits, and provides administrative and technical support to the Council on Revenues.

During the 1999 legislative session, TR&P reviewed over 300 tax proposals for impact on tax revenues. Eighteen of these proposals were enacted into law. The "Legislation" section lists each of these acts with a brief description. Significant to the department was Act 155 as it allowed for an Integrated Tax Information Management Systems Special Fund to pay for the ITIMS project to replace the existing CNIT and GEW/TAT systems.

Throughout the year, TR&P provides support to the Council on Revenues which consists of seven community members who provide the state with projections of state general fund revenues and state total personal income. This information is used to determine the state's expenditure ceiling. The Council estimated a 0.5% growth in general fund tax revenues for FY 1999 and a 2.0% growth for total personal income in CY 1998. Actual general fund revenues of \$2,854.5 million for FY 1999 represent a 0.2% growth over FY 1998. Total personal income for CY 1998 amounted to nearly \$32.0 billion, representing a 2.5% growth from the previous year.

TR&P completed three publications for this fiscal year. "Tax Credits Claimed by Hawaii Residents (1996)" was published in December 1998. For tax year 1996, 86% of Hawaii residents filing returns, claimed \$46.7 million in tax credits, of which more than half was for the food tax credit. In January 1999, "Hawaii Income Patterns - Individuals (1996)" presented results of individual income tax returns filed for tax year 1996. As reported, total adjusted gross income for Hawaii residents amounted to \$16.0 billion, of which \$11.5 billion was taxable. "Hawaii Income Patterns - Corporation, Proprietorship, Partnership (1995)" (published every third year) was published in February 1999. A total of 109,443 returns were filed by businesses whose fiscal year ended in 1995. Total gross receipts of \$53.2 billion was reported for the fiscal year ending 1995.

TAXPAYER ADVOCACY PROGRAM

The Taxpayer Advocacy Program provides a one-stop service for taxpayer concerns that cannot be resolved through normal channels and is administered by the department's Taxpayer Advocate. Focus is on the needs of the taxpayer on a case-by-case basis.

For fiscal year ending 1999, the advocacy program assisted 140 taxpayers with the resolution of their tax matters. Issues addressed included erroneous billings, erroneous reports of state tax refund income (Form 1099-G), inquiries about refunds, waivers of penalty and interest, assistance with offers in compromise, taxpayer rights, verifications of balance due, explanation of letters, non-filing of tax returns and billings.

Twenty-six additional cases did not require intervention by the Taxpayer Advocate. Most of these were resolved by guiding the taxpayer to the right management personnel.

During fiscal 1999, the Taxpayer Advocate coordinated the department's joint "Problem Solving Days" with the Internal Revenue Service on the islands of Oahu, Molokai, and Kauai. This effort assisted 136 taxpayers with problems such as non-filing of tax returns, amended tax returns, corrections to tax assessments cases based on IRS adjustments, penalty and interest inquiries, payment plans, offers in compromise, and tax information.

Most taxpayers have been satisfied with the outcome of their cases, regardless of whether a decision was made in their favor. The Taxpayer Advocate has focused on taxpayers' needs while maintaining taxpayer confidence that the department will administer Hawaii's tax laws in a consistent, uniform and fair manner.

MANAGEMENT PERSONNEL

OFFICE OF THE DIRECTOR

Director of Taxation Ray K. Kamikawa
Deputy Director of Taxation Marie Y. Okamura

STAFF OFFICES

Rules Officer Grant Tanimoto
Tax Research & Planning Officer Francis Okano
Information Technology Services Officer Clay Sato
Administrative Services Officer Warren Higashi
Personnel Officer Stanley Onaga

OPERATIONS STAFF

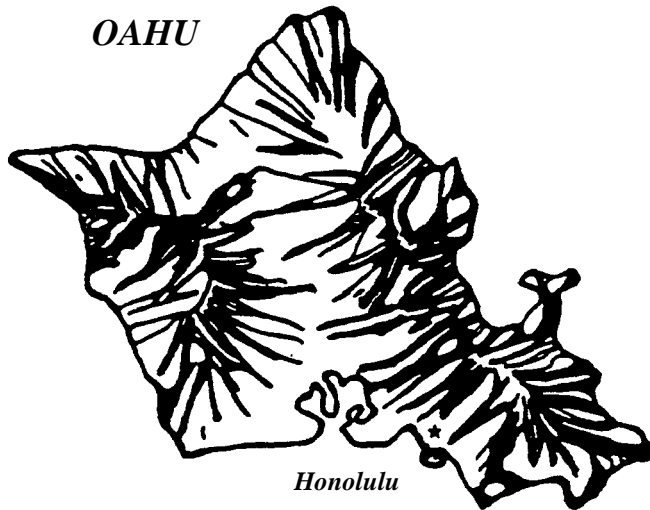
Compliance Division Chief Ronald Randall
Oahu Field Audit Branch Wayne Griffin
Oahu Office Audit Branch Vacant
Oahu Collection Branch Vacant
Maui District Tax Manager Stanley Ching
Hawaii District Tax Manager Ronald Yabe
Kauai District Tax Manager Ernest Balderas

Tax Services and Processing Division Chief Vacant
Taxpayer Services Branch June Yamamoto
Document Processing Branch Jerry Ebesu
Revenue Accounting Branch Deanne Obatake

FIRST TAXATION DISTRICT

Island of Oahu

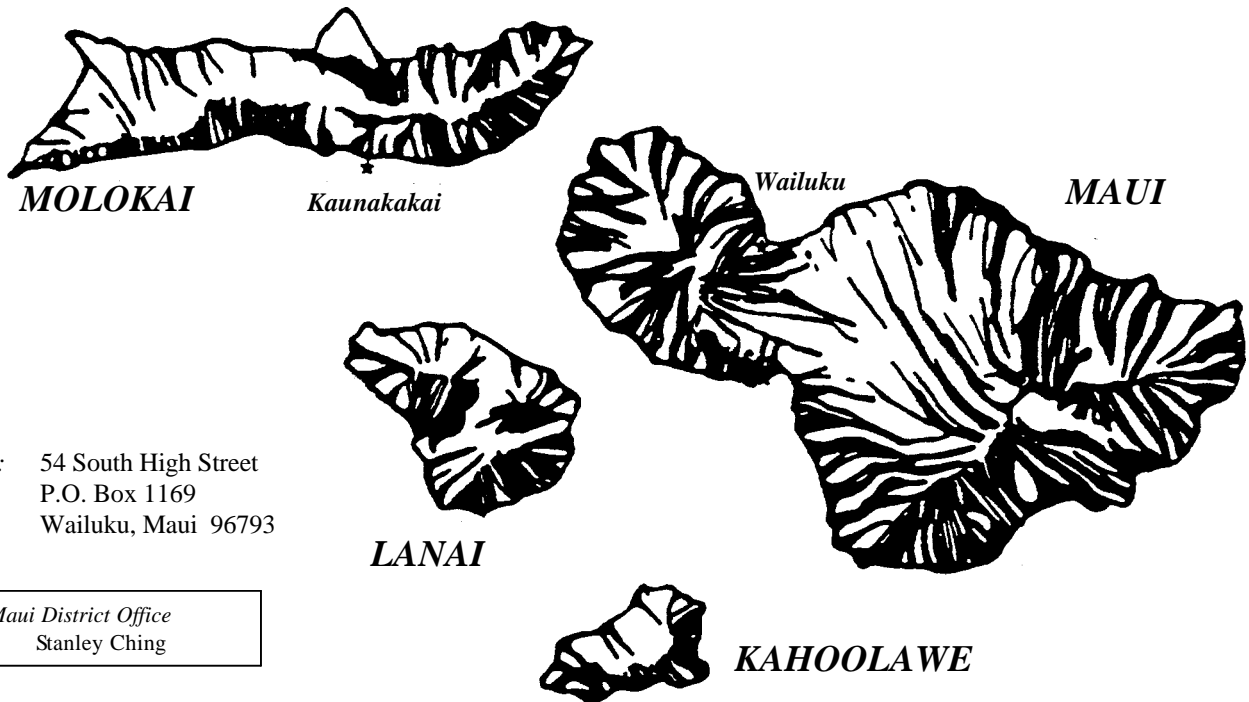
Office: 830 Punchbowl Street
P.O. Box 259
Honolulu, Hawaii 96809



<i>Compliance Division Chief</i> Ronald Randall
<i>Oahu Office Audit Branch</i> Vacant
<i>Oahu Field Audit Branch</i> Wayne Griffin
<i>Oahu Collection Branch</i> Vacant
<i>Tax Services & Processing Branch Chief</i> Vacant
<i>Taxpayer Services Branch</i> June Yamamoto
<i>Document Processing Branch</i> Jerry Ebesu
<i>Revenue Accounting Branch</i> Deanne Obatake

SECOND TAXATION DISTRICT

Islands of Maui, Molokai, and Lanai



Office: 54 South High Street
P.O. Box 1169
Wailuku, Maui 96793

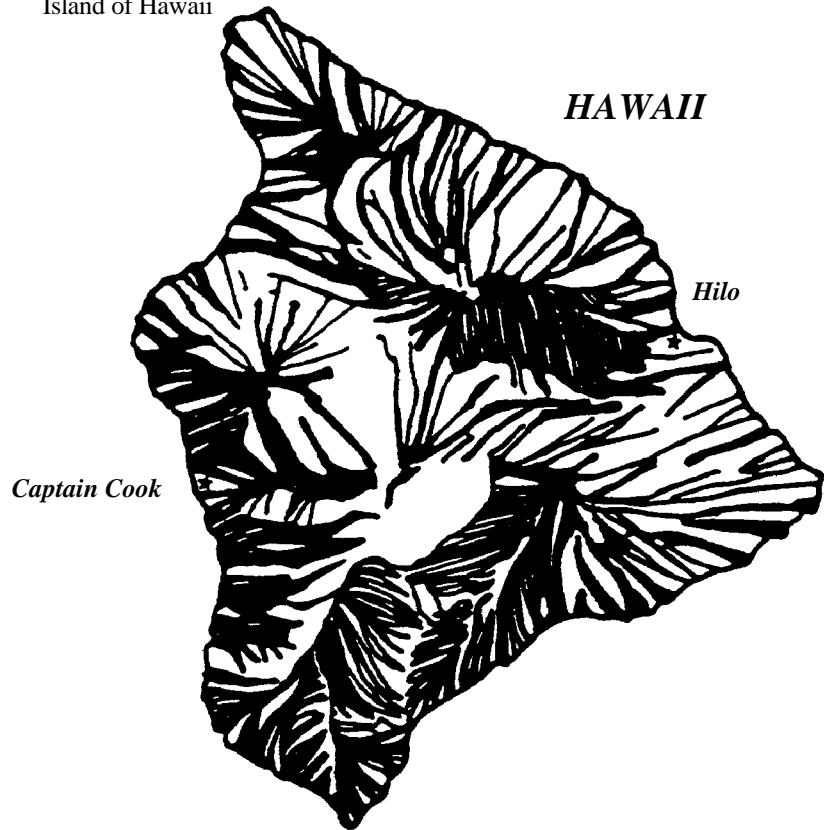
<i>Maui District Office</i> Stanley Ching
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THIRD TAXATION DISTRICT

Island of Hawaii

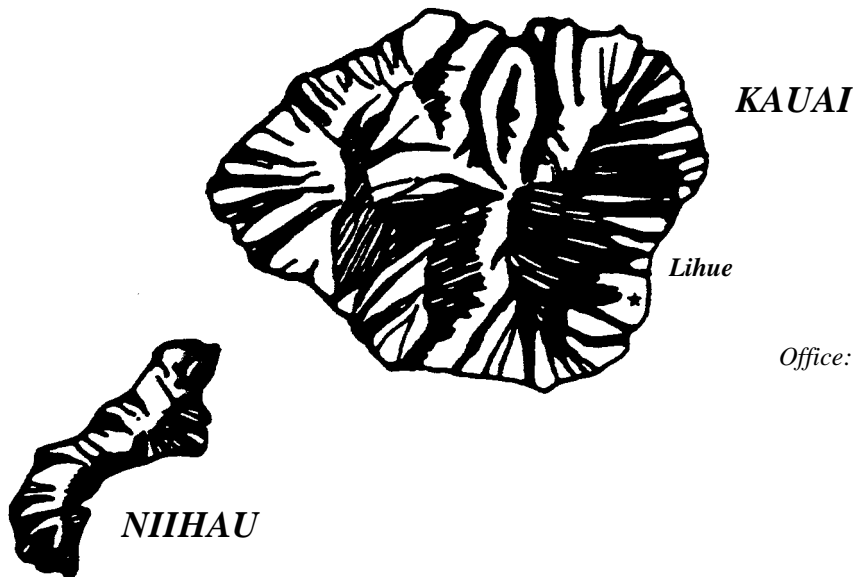
Office: 75 Aupuni Street
P.O. Box 833
Hilo, Hawaii 96721

Hawaii District Office
Ronald Yabe



FOURTH TAXATION DISTRICT

Islands of Kauai and Niihau

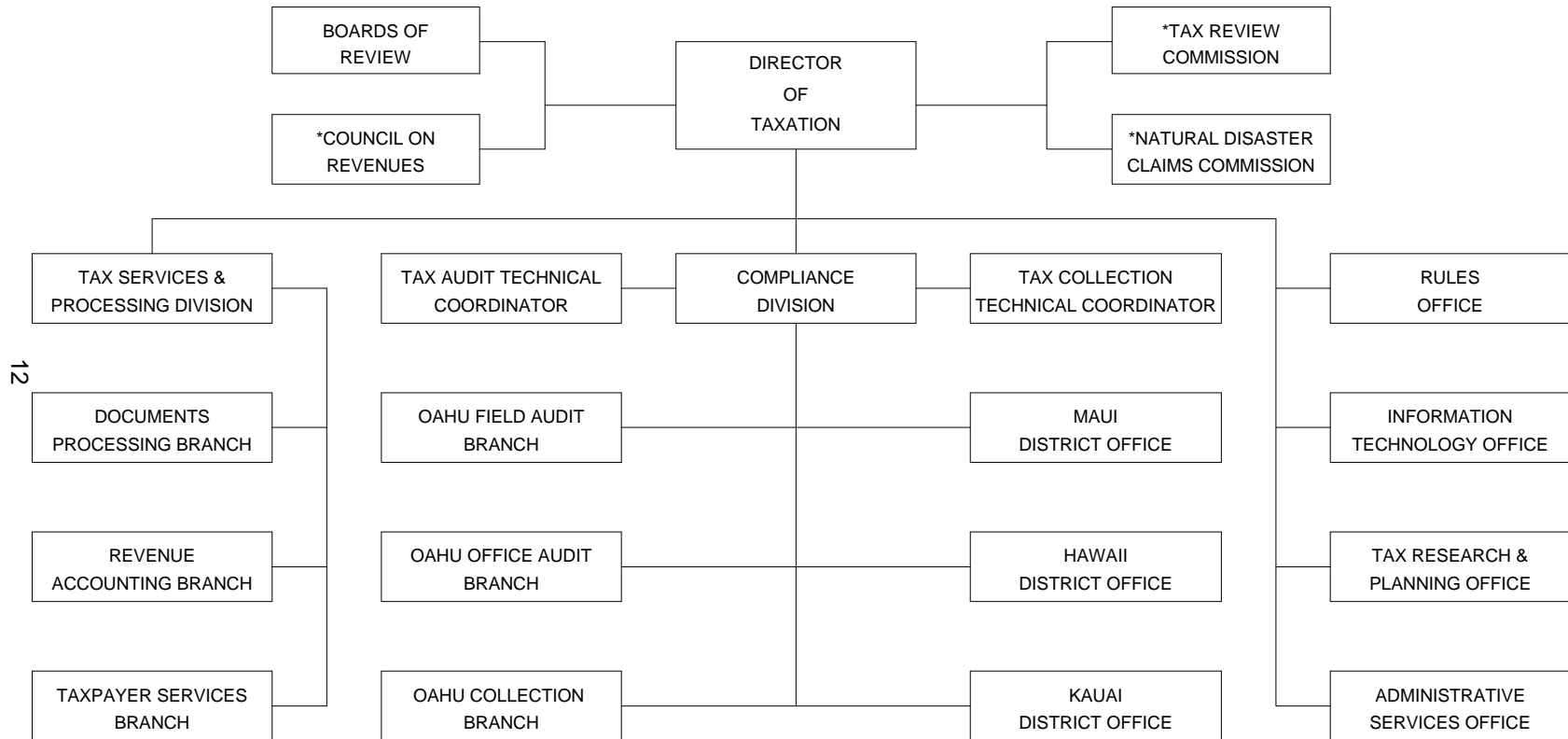


Office: 3060 Eiwa Street #105
Lihue, Kauai 96766

Kauai District Office
Ernest Balderas

ORGANIZATION CHART

Department of Taxation
State of Hawaii



* For administrative purposes.

TAX APPEALS AND LITIGATION

BOARDS OF REVIEW

A Board of Review, consisting of five members, is established in each taxation district. Tax disputes that are not resolved at the district tax office level are presented to the Board of Review. Statewide, the boards began the fiscal year with 61 pending tax appeals. Although 15 appeals were settled, 34 new appeals were filed, resulting in a total of 80 appeals pending at year end. A summary of the number of appeals before the boards by tax district follows:

	<u>Oahu</u>	<u>Maui</u>	<u>Hawaii</u>	<u>Kauai</u>	<u>Total</u>
Appeals Pending - Beginning	52	4	5	0	61
New Appeals Filed	26	4	4	0	34
Appeals Settled	9	0	6	0	15
Appeals Pending - Ending	69	8	3	0	80

COURT DECISIONS

Bruce R. Travis et al. v. Department of Commerce and Consumer Affairs et al., Civ. No. 98-0216(3), Supreme Court of the State of Hawaii

The plaintiff brought a complaint for declaratory judgment claiming that Hawaii's general excise and net income tax laws violated his constitutional rights. The Circuit Court held that the State, as a sovereign entity, is immune from suits for money damages for alleged constitutional violations. The Hawaii Supreme Court issued a summary disposition order affirming the Circuit Court's decision.

In Re Tax Appeal of United Parcel Service, Inc., Case No. 97-3281, Supreme Court of the State of Hawaii

The issue in this case was whether federal preemption of state taxation of air transportation extends to ground transportation that is connected to air transportation. The Tax Appeal Court ruled that federal law preempts state taxation of these revenues. The Hawaii Supreme Court reversed the Tax Appeal Court holding that federal laws prohibiting state taxation of "air transportation" did not preempt state taxation of the ground transportation portion of air package delivery service.

In Re Tax Appeal of Lynden Air Freight, Inc., Case No. 98-1359, Supreme Court of the State of Hawaii and United States Supreme Court

The issue in this case was the same federal preemption issue in In Re Tax Appeal of United Parcel Service, Inc. The Tax Appeal Court ruled that federal law preempted state taxation. The Hawaii Supreme Court reversed the Tax Appeal Court holding that federal laws prohibiting state taxation of "air transportation" did not preempt state taxation of the ground transportation portion of air package delivery service. The United States Supreme Court denied the taxpayer's petition for certiorari.

In Re Tax Appeal of Grace Business Development Corporation, Case No. 98-0037, Tax Appeal Court of the State of Hawaii

The taxpayer filed an appeal in the Tax Appeal Court for a tax refund and a declaratory judgment that it is a business development corporation exempt from general excise and transient accommodations taxes without first requesting that the department refund its tax payment paid under protest. The Court held that it lacked jurisdiction because taxes had not yet been assessed and declaratory relief in tax controversies is prohibited. The taxpayer has filed an appeal to the Hawaii Supreme Court.

In Re Tax Appeal of Johnson Bros. of Hawaii, Inc., Case No. 97-0240, Tax Appeal Court of the State of Hawaii

The taxpayer claimed it was exempt from the use tax because it is a wholesaler both when it imports alcoholic beverage for resale to military outlets and when it sells alcoholic beverages to military retail outlets. The Department's position was that the taxpayer is not a wholesaler under HRS §237-4 because the federal government is not a licensed seller. By stipulated judgment, the parties agreed that the State would retain the full amount of use tax and interest assessed for October 1, 1992 through February 28, 1995, and that the taxpayer would report and pay Hawaii use taxes for all periods after December 31, 1995.

In Re Tax Appeal of Computer Sciences Corp., Case No. 97-245, Tax Appeal Court of the State of Hawaii

The issue in this case was whether computer hardware and software development, upgrade, enhancement, installation and maintenance work qualified as exempt scientific work under HRS §237-26. By stipulated judgment, the parties agreed that the State would receive full payment of the taxes in the amount of \$336,613 and that the taxpayer would prospectively comply.

In Re Tax Appeal of Adolph Coors Co., Case No. 98-0077, Tax Appeal Court of the State of Hawaii

The Taxpayer claimed it was exempt from general excise tax because title to the beer it sold to a Hawaii distributor passed to the distributor outside of the state, and it was exempt from use tax because the kegs and shipping materials it brought into the State only remained here temporarily. The department's position was that the place of delivery of the beer determines whether the taxpayer is subject to general excise tax, and since the kegs and shipping materials were routinely and repeatedly shipped to Hawaii, the taxpayer was subject to use tax for the first time the kegs and shipping materials were shipped here. By stipulated judgment, the parties agreed that the taxpayers would pay all of the general excise tax assessed in the amount of \$543,326 and prospectively pay use taxes from January 1, 1999, and the department would not make use or general excise tax assessments for 1996-1998.

In Re Tax Appeal of Coors Brewing Co., Case No. 97-0078, Tax Appeal Court of the State of Hawaii

This appeal was consolidated with the tax appeal of Adolph Coors because Coors Brewing Company, a subsidiary of Adolph Coors took over the beer sales to the Hawaii distributor in 1990. The issues and claims of the two appeals are the same and the stipulated judgment mentioned above includes both appeals.

State v. Campbell, dba Hiki No Trucking, Case No. 99-S0301, First Circuit Court of the State of Hawaii

The department's first prosecution recommendation on a public service company for failure to file public service company tax returns resulted in a "no-contest" plea by the defendant. The defendant is awaiting sentencing.

State v. American Welding, Inc. and Nettie Kaahaaina, Crim. No. 99-S0302, First Circuit Court of the State of Hawaii

The defendants' theft of employees' state withholding taxes and failure to file general excise tax returns resulted in a plea agreement under which all charges were dismissed against the corporation. Mrs. Kaahaaina awaits sentencing.

State v. Multimedia Pacific, Inc. and Chris Waidzunus, Crim. No. 98-2223, First Circuit Court of the State of Hawaii and State v. Dart Systems of Hawaii, Case No. 7P199-04926, District Court of the First Circuit State of Hawaii

In both cases, the defendants' failure to file annual general excise tax returns resulted in guilty pleas. The defendants were each fined \$50,000.

OTHER MATTERS CLOSED

Tax Appeals	6
Bankruptcies	366
Foreclosures	116
Subpoenas	39
Opinions	37
Contracts/Bids	14
Legislation	35
Miscellaneous	39
Criminal	13

AMOUNTS COLLECTED

Tax Appeals	\$ 1,475,734.94
Foreclosures	55,810.53
Bankruptcies	1,510,809.00
Miscellaneous	61,758.59
Criminal	262,559.00
TOTAL	\$ 3,366,672.06

LEGISLATION

During its regular session, the 1999 legislature passed the following tax-related bills, one of which was vetoed by the Governor.

Act Brief Description

- | | |
|-----|---|
| 010 | Amends HRS §245-3 to restore the exemption from cigarette and tobacco taxes for sales to the military. <i>Effective: Retroactive to taxable periods beginning after June 30, 1993.</i> |
| 024 | Expands qualification for low-income housing credit to include insurance companies; the credit is now available to income taxpayers and financial institutions. <i>Effective for taxable years beginning after December 31, 1998.</i> |

- 068 Allows collection agencies under a contract with the Department of Taxation to collect their fees directly from taxpayers. *Effective: June 10, 1999.*
- 070 Exempts exported services from general excise and use tax (including bundled contracting or services). Imposes the use tax on imported services. *Effective: GET exemption applies to gross receipts received on or after January 01, 2000; use tax applies to taxes accruing on or after January 01, 2000.*
- 071 Expands the application of the general excise tax wholesale treatment to the following transactions: (1) Tangible personal property-to-services; (2) Tangible personal property-to-transient accommodations; (3) Services-to-services; (4) Services-to-tangible personal property; (5) Services-to-contracting; and (6) Services-to-transient accommodations; excluding purchases of "overhead." Phases in the new lower rate for these transactions over a 7 year period (4% rate decreases by 0.5% each year). Allows the department to effectuate the rate change by allocation, deduction, or other method. Preserves the 1/2% general excise tax rate for transactions that already qualify for wholesale treatment under current law. Clarifies that "service business or calling" includes professional services. Provides for corresponding use tax treatment. *Effective: GET provisions apply to gross receipts received on or after January 01, 2000; use tax provision applies to taxes accruing on or after January 01, 2000.*
- 081 Creates a College Savings Program in conformance with the requirements of IRC §529. Director of Finance or other designee files report with the Department of Taxation regarding information on accounts and beneficiaries. *Effective for taxable years beginning after December 31, 1999.*
- 155 Creates the Integrated Tax Information Management Systems Special Fund to pay for the Integrated Tax Information Management System. Special fund sunsets on July 1, 2004. Appropriates \$17,750,828 for FY 1999-2000 and \$7,480,428 for FY 2000-2001. *Effective: July 01, 1999.*
- 160 Amends HRS §92-21 to provide for individual development accounts (IDAs) and creates an exemption for contributions to an IDA (including interest earned) and a "tax credit" of an unspecified type equal to 50% of a contribution to an IDA. *Effective: Copying fees - July 01, 1999 ; IDA tax credit and exemption - June 28, 1999.*
- 165 Amends §237-23.5 and §237-24.7 by clarifying the definition of "related entities" to guard against corporations that try to claim related party status by using valuation methods (which include control premiums and minority discounts). *Effective: For gross receipts received after June 30, 1999.*
- 173 Reverses a Departmental rule adopted in 1993 which subjects sales of containers and bulk condiments to eating and drinking retailers to the 1/2% GET rate, but subjects sales of prepackaged condiments and containers to an eating or drinking retailer to the 4% general excise tax rate. Cures disparate treatment by allowing 1/2% GET rate for sales of prepackaged condiments to eating and drinking retailers. Makes a technical correction to clarify that one-half percent intermediary rate is applicable to professional services. *Effective: For gross receipts received after June 30, 1999.*
- 178 Supports high technology industry growth by promoting work force development programs, exempting stock options from high technology businesses from income tax, creating tax credits for investment in high technology businesses, etc. *Effective for taxable years beginning after December 31, 1999.*
- 198 Conforms Hawaii Income Tax Law to the Internal Revenue Code, by including provisions from the IRS Restructuring and Reform Act of 1998, Surface Transportation Revenue Act of 1998, and Tax and Trade Relief Extension Act of 1998. *Effective for taxable years beginning after December 31, 1998.*
- 223 Increases rental motor vehicle surcharge tax from \$2 to \$3; exempts rentals of a vehicle to replace another vehicle being repaired when the taxpayer retains the repair order for the vehicle for verification purposes. Designates \$11 million from state highway fund moneys to be deposited into the state general fund for fiscal years 1999-2000 and 2000-2001. *Effective for periods beginning September 01, 1999 to August 31, 2007.*
- 253 Repeals HRS §235-4.3 (Act 281, SLH 1997) because of overwhelming compliance burdens for taxpayers and disincentive for economic activity in Hawaii. Amends HRS §235-5 to apply the ratio of Hawaii source income over total source income to a nonresident taxpayer's personal exemption and standard deduction. The change in treatment also applies to part-year residents who were also affected by Act 281, SLH 1997. *Effective for taxable years beginning after December 31, 1998.*
- 270 Conforms Hawaii income tax law to the federal itemized deduction for long-term care premiums and expenses (IRC §213). *Effective for taxable years beginning after December 31, 1998.*
- 295 Exempts from the conveyance tax transfers of real property from: (1) an individual to a business entity that is partly or wholly owned by the individual; (2) a business entity to any of its shareholders, partners or members; or (3) between a general or limited partnership and a limited liability company. *Effective: July 06, 1999.*
- 303 Allows probation as an option for sentencing for tax offenses. *Effective: July 06, 1999.*
- 306 Establishes a qualified improvement tax credit for both a "qualified resort facility" and a "qualified general facility." Credit amounts for both types of facilities are an unspecified percentage of capitalized costs of construction and equipment of a permanent nature. Credit may be carried forward for 10 years and may be applied against general excise, income, public service company, or transient accommodations taxes. *Effective for taxable years 1999 through 2005.*

INCOME ASSESSMENT AND AUDIT

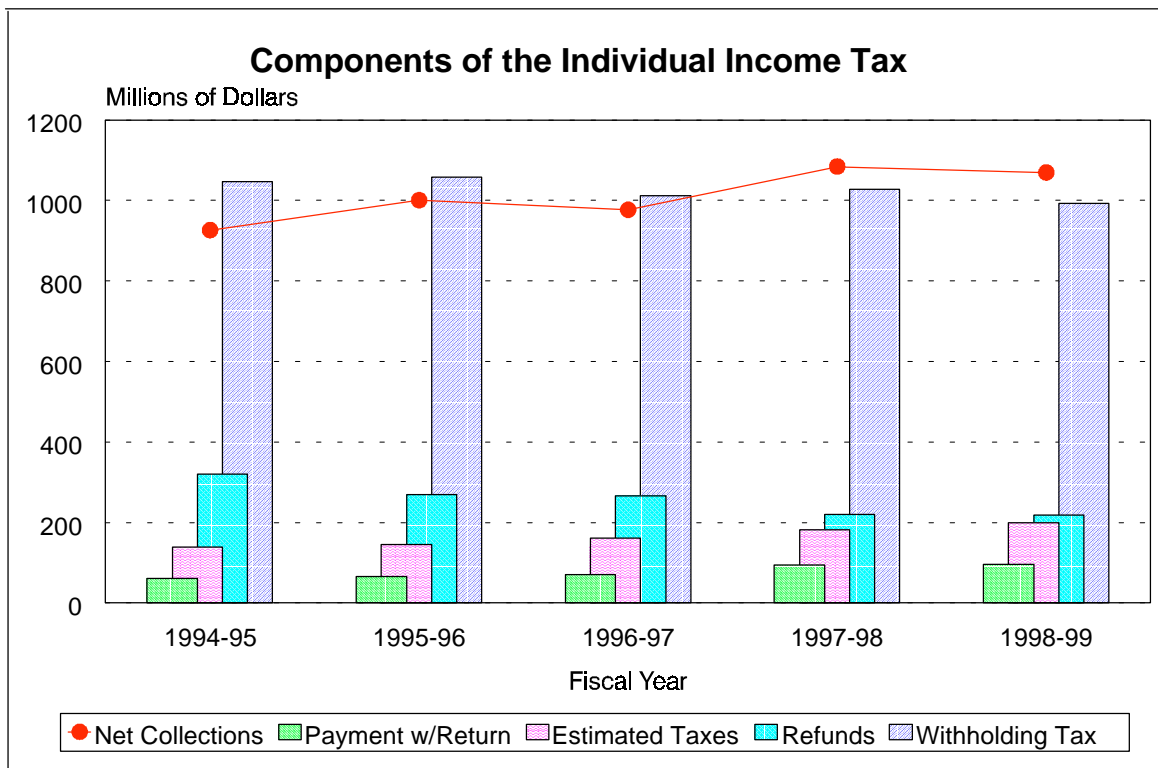
INDIVIDUAL INCOME TAX

Act 157, enacted by the 1998 legislature, made several changes to the Income Tax Law. Tax rates were lowered in three stages beginning in tax year 1999, and the food tax credit was replaced by a refundable low-income tax credit. A drop in withholding rates effective January 1999 resulted in a reduced revenue from withholding taxes after January. This decline in withholding taxes and the increase in refunds resulted in an overall drop in individual income taxes collected. The first half of FY 1999 show a 1.8% increase compared to a 4.5% drop in the second half. Individual income taxes totaled \$1,068.7 million, \$14.9 million less than the previous year.

TAXES PAID BY INDIVIDUALS (In Thousands of Dollars)

	FY 1999	FY 1998	Difference	
			Amount	%
Declaration of Estimated Taxes	\$ 199,116	\$ 182,182	\$ 16,934	9.3
Payment with Return	95,918	94,194	1,724	1.8
Withholding Tax on Wages	992,345	1,027,746	-35,401	-3.4
Subtotal	\$ 1,287,379	\$ 1,304,123	\$ -16,743	-1.3
Refunds	218,669	220,472	-1,803	-0.8
NET	<u>\$ 1,068,711</u>	<u>\$ 1,083,651</u>	<u>\$ -14,940</u>	<u>-1.4</u>

NOTE: Due to rounding detail may not add to totals.



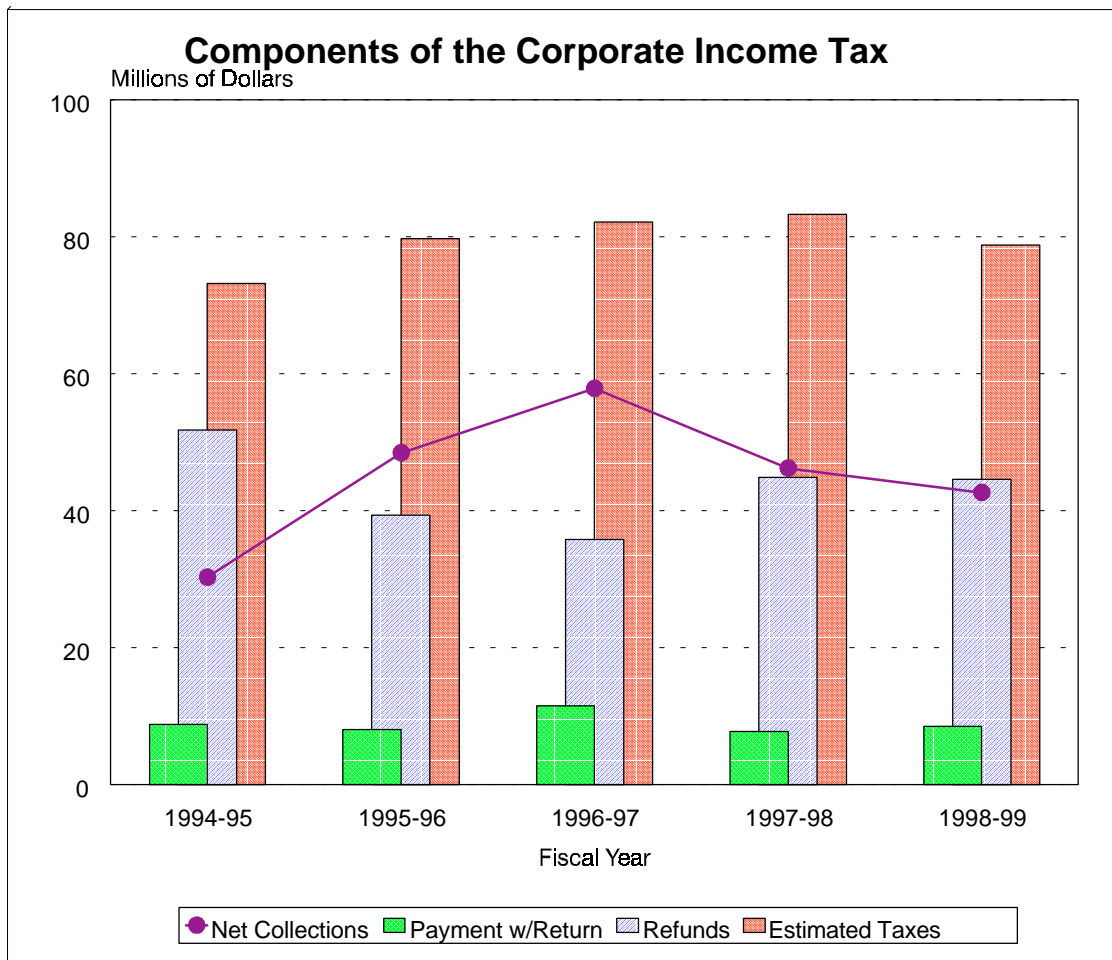
CORPORATE INCOME TAX

While payments with returns increased by \$0.7 million, a \$4.5 million drop in estimated taxes and a \$0.2 million decrease in refunds resulted in an overall drop in corporate income taxes from \$46.2 million to \$42.6 million in FY 1999. This represents a 7.7% drop, or a loss of \$3.6 million.

TAXES PAID BY CORPORATIONS (In Thousands of Dollars)

	FY 1999	FY 1998	Difference	
			Amount	%
Declaration of Estimated Taxes	\$ 78,785	\$ 83,256	\$ -4,471	-5.4
Payment with Return	8,469	7,779	690	8.9
Subtotal	\$ 87,254	\$ 91,035	\$ -3,781	-4.2
Refunds	44,611	44,826	-215	-0.5
NET	<u>\$ 42,643</u>	<u>\$ 46,209</u>	<u>\$ -3,566</u>	<u>-7.7</u>

NOTE: Due to rounding detail may not add to totals.



GENERAL EXCISE AND USE TAX BASE AND TAXES
FOR FISCAL YEARS ENDING JUNE 30, 1999 & 1998
(In Thousands of Dollars)

SOURCE OF REVENUE	Rate	1999	1998*	Difference	
				Amount	% change
TAX BASE					
Retailing		\$ 15,852,717	\$ 15,840,733	\$ 11,983	0.1
Services		5,634,374	5,447,645	186,729	3.4
Contracting		3,021,658	2,944,740	76,918	2.6
Hotel Rentals		2,112,518	2,197,268	-84,751	-3.9
All Other Rentals		3,720,009	3,780,443	-60,434	-1.6
All Others (4%)		<u>2,824,466</u>	<u>2,748,852</u>	<u>75,614</u>	<u>2.8</u>
Subtotal		\$ 33,165,741	\$ 32,959,682	\$ 206,059	0.6
Sugar Processing		\$ 1,697	\$ 9,842	\$ -8,145	-82.8
Pineapple Canning		6,035	4,496	1,539	34.2
Producing		486,122	509,721	-23,600	-4.6
Manufacturing		557,243	562,125	-4,882	-0.9
Wholesaling		7,871,248	8,294,657	-423,408	-5.1
Use (½%)		4,111,962	4,055,038	56,923	1.4
Intermediary Services		334,303	294,327	39,977	13.6
Insurance Commissions		<u>632,174</u>	<u>822,275</u>	<u>-190,101</u>	<u>-23.1</u>
Subtotal		\$ 14,000,784	\$ 14,552,482	\$ -551,698	-3.8
TOTAL - ALL ACTIVITIES		<u>\$ 47,166,525</u>	<u>\$ 47,512,164</u>	<u>\$ -345,639</u>	<u>-0.7</u>
TAX					
Retailing	4%	\$ 634,109	\$ 633,629	\$ 479	0.1
Services	4%	225,375	217,906	7,469	3.4
Contracting	4%	120,866	117,790	3,077	2.6
Hotel Rentals	4%	84,501	87,891	-3,390	-3.9
All Other Rentals	4%	148,800	151,218	-2,417	-1.6
All Others (4%)	4%	<u>112,979</u>	<u>109,954</u>	<u>3,025</u>	<u>2.8</u>
Subtotal		\$ 1,326,630	\$ 1,318,387	\$ 8,242	0.6
Sugar Processing .....	.50%	\$ 8	\$ 49	\$ -41	-82.8
Pineapple Canning .....	.50%	30	22	8	34.2
Producing .....	.50%	2,431	2,549	-118	-4.6
Manufacturing .....	.50%	2,786	2,811	-24	-0.9
Wholesaling .....	.50%	39,356	41,473	-2,117	-5.1
Use (½%) .....	.50%	20,560	20,275	285	1.4
Intermediary Services .....	.50%	1,672	1,472	200	13.6
Insurance Commissions .....	.15%	<u>948</u>	<u>1,233</u>	<u>-285</u>	<u>-23.1</u>
Subtotal		\$ 67,791	\$ 69,884	\$ -2,093	-3.0
Unallocated**		52,857	37,080	15,777	42.5
TOTAL - ALL ACTIVITIES		<u>\$ 1,447,278</u>	<u>\$ 1,425,352</u>	<u>\$ 21,927</u>	<u>1.5</u>

NOTE: Due to rounding detail may not add to totals.

* Revised.

** Included are collections from penalty and interest, assessments and corrections, delinquent collections, refunds, protested payments, settlements, etc.

GENERAL EXCISE AND USE TAXES

General excise and use taxes make up over 40% of total tax collections in the state. Since 1961, general excise and use tax collections have increased each year until last fiscal year. Following a drop in this last fiscal year, collections for FY 1999 increased a modest 1.5% from \$1.43 billion in FY 1998 to \$1.45 billion. Comprising 44% of total general excise and use tax collections, retailing activities increased by \$0.5 million, after a \$28.0 million drop in FY 1998.

TRANSIENT ACCOMMODATIONS TAX

Effective January 1, 1999, under Act 156, the transient accommodations tax (TAT) rate was increased to 7.25% of gross revenues and the tax was also imposed on time share units. A tourism special fund was established, to which \$29.0 million of tax collections was distributed. Although TAT collections grew by \$9.5 million, or 7.4%, with the tourism special fund, payments into the general fund dropped by more than half of last year's total to \$2.5 million. This redistribution of funds also caused an \$18.9 million drop in revenues for the counties.

TRANSIENT ACCOMMODATIONS TAX (In Thousands of Dollars)

	FY 1999	FY 1998	Difference	
			Amount	%
Transient Accom./Time Share Occup. Tax	\$ 136,533	\$ 127,076	\$ 9,457	7.4
Transient Accom./Time Share Occup. Fees	8	5	2	46.5
Subtotal	\$ 136,541	\$ 127,081	\$ 9,460	7.4
Counties Share	81,748	100,602	-18,854	-18.7
Conventional Center Fund	23,241	21,179	2,062	9.7
Tourism Special Fund	29,049	0	--	--
General Fund	\$ 2,503	\$ 5,300	\$ -2,797	-52.8%

NOTE: Due to rounding detail may not add to totals.

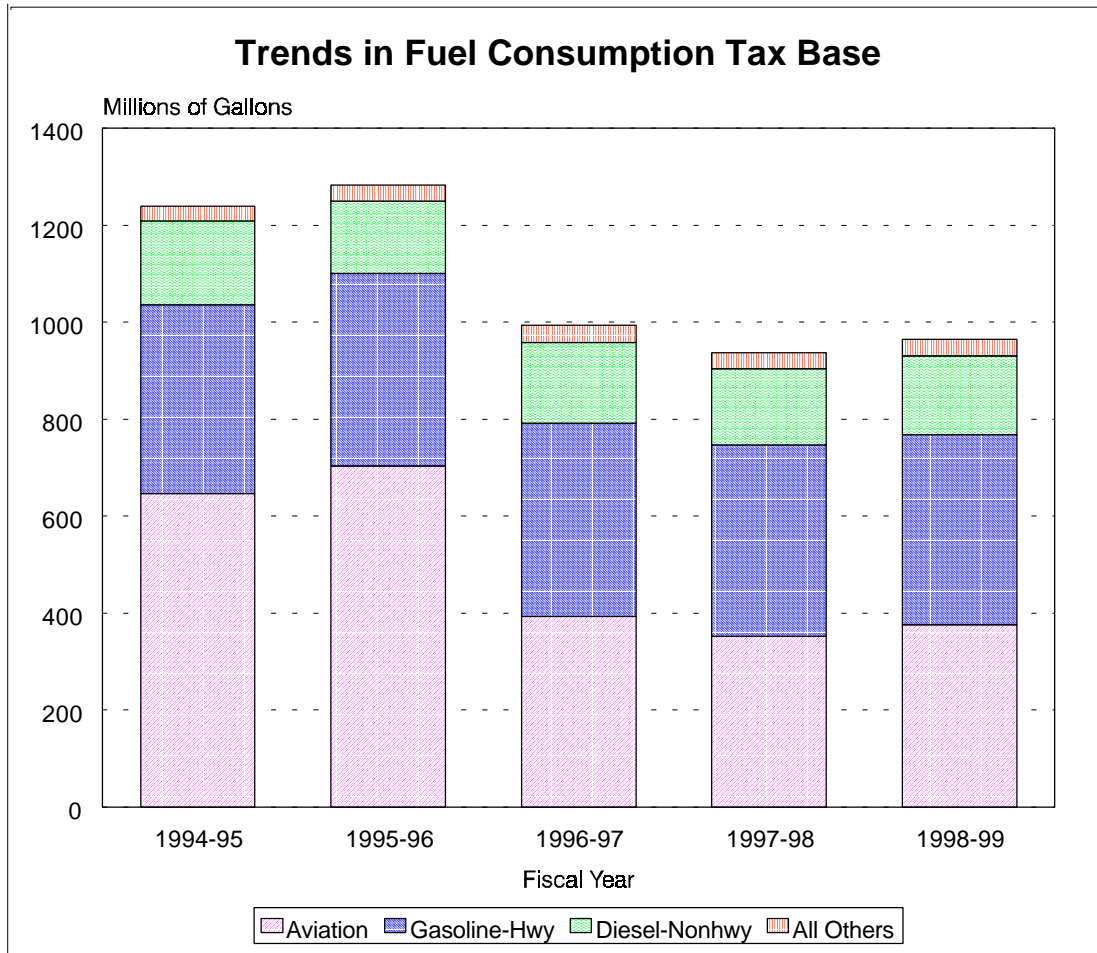
FUEL AND MOTOR VEHICLE TAXES

Fuel consumption increased 28.2 million gallons to 965.1 million gallons in FY 1999, representing a 3.0% increase over the previous year. Aviation fuel which accounted for 38.9% of total taxable fuel consumption had the biggest increase of 24.1 million gallons. Gasoline consumption dropped by 3.1 million gallons, while diesel oil for off and on highway use grew by 7.4 million gallons. An environmental response tax of 5¢ is imposed on each barrel of petroleum sold by a distributor to any retail dealer or end user other than a refiner of petroleum products.

GALLONS OF FUEL CONSUMED
(In Thousands of Gallons)

	FY 1999	FY 1998	Difference	
			Amount	%
Gasoline	392,811	395,866	-3,054	-0.8
Diesel Oil - Nonhighway	161,639	156,597	5,042	3.2
Diesel Oil - Highway	31,333	29,015	2,317	8.0
Liq. Pet. Gas - Off Highway	3,282	3,446	-164	-4.8
Liq. Pet. Gas - Highway	361	375	-14	-3.8
Small Boats - Gasoline	7	26	-19	-74.0
Small Boats - Diesel Oil	123	168	-46	-27.2
Aviation Fuel	<u>375,577</u>	<u>351,470</u>	<u>24,107</u>	<u>6.9</u>
TOTAL - GALLONS	<u>965,133</u>	<u>936,963</u>	<u>28,169</u>	<u>3.0</u>
Environmental Tax (Barrels)	35,302	33,928	1,374	4.0

NOTE: Due to rounding detail may not add to totals.



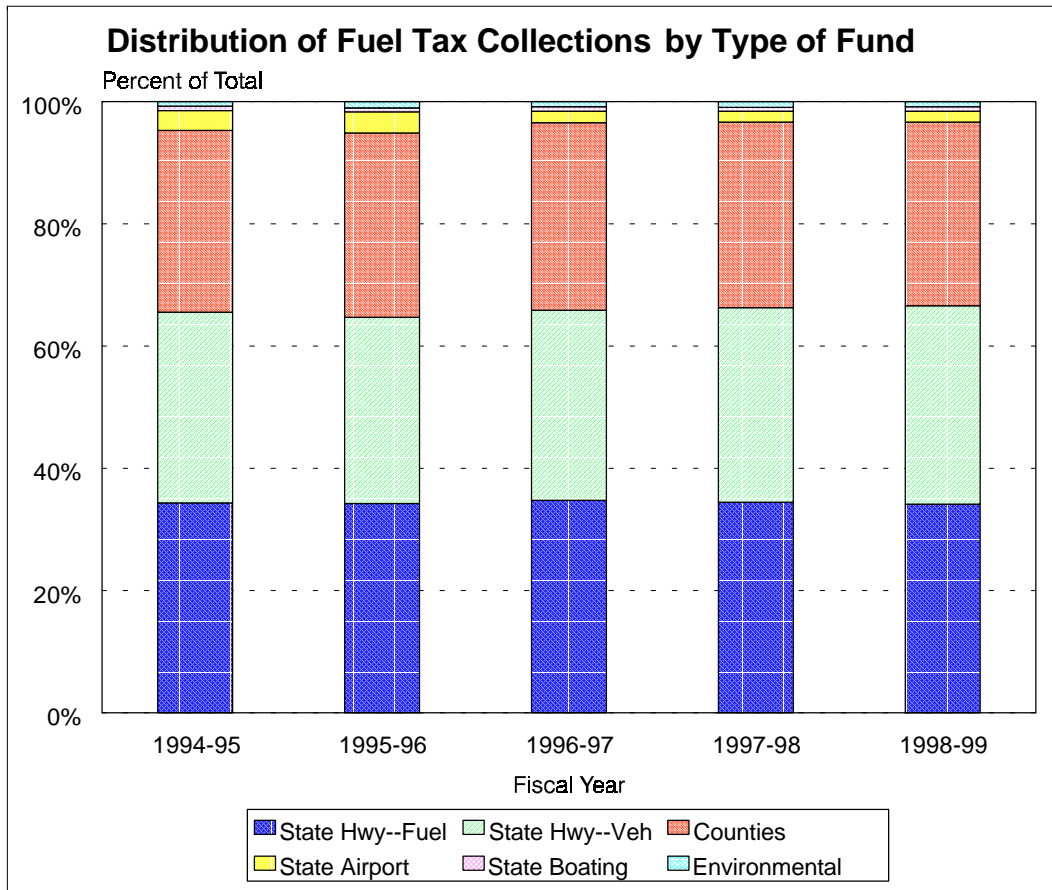
Fuel taxes collected are distributed to both the state and counties, and to other special funds. The environmental response tax is deposited into the environmental response revolving fund, which is administered by the Department of Health for its oil spill prevention and remediation programs. Revenues from the aviation fuel tax is deposited into the airport fund, while all other state fuel tax collections are deposited into the state highway fund, except for 1% of state and county fuel taxes which is deposited into the state boating fund. Revenues from the motor vehicle weight taxes and fees, which are administered and collected by the counties, and rental motor vehicle and tour vehicle surcharge taxes are also added to the state highway fund.

ALLOCATION OF FUEL TAXES
(In Thousands of Dollars)

	FY 1999	FY 1998	Difference	
			Amount	%
STATE HIGHWAY FUND:				
Gasoline	\$ 62,144	\$ 62,564	\$ -420	-0.7
Diesel Oil - Nonhighway	1,601	1,552	49	3.2
Diesel Oil - Highway	4,963	4,596	367	8.0
Liq. Pet. Gas - Off highway	32	34	-2	-4.8
Liq. Pet. Gas - Highway	39	41	-2	-3.8
Subtotal	\$ 68,780	\$ 68,787	\$ -7	-0.0
Motor Vehicle Weight Tax/Reg. Fees	41,763	40,710	1,052	2.6
Rental Vehicle Surcharge Tax/Fees	23,592	22,838	753	3.3
TOTAL	<u>\$ 134,134</u>	<u>\$ 132,335</u>	<u>\$ 1,799</u>	<u>1.4</u>
COUNTY HIGHWAY FUNDS:				
City & County of Honolulu	\$ 44,518	\$ 45,214	\$ -696	-1.5
County of Maui	7,442	7,212	230	3.2
County of Hawaii	5,918	5,816	102	1.8
County of Kauai	2,532	2,439	93	3.8
TOTAL	<u>\$ 60,410</u>	<u>\$ 60,681</u>	<u>\$ -271</u>	<u>-0.4</u>
BOATING SPECIAL FUND	<u>\$ 1,305</u>	<u>\$ 1,308</u>	<u>\$ -3</u>	<u>-0.2</u>
STATE AIRPORT FUND:				
Aviation Fuel	<u>\$ 3,756</u>	<u>\$ 3,515</u>	<u>\$ 241</u>	<u>6.9</u>
ENVIRONMENTAL TAX FUND	<u>\$ 1,765</u>	<u>\$ 1,696</u>	<u>\$ 69</u>	<u>4.0</u>

NOTE: Due to rounding detail may not add to totals.

The state legislature sets the state fuel tax rates while the county councils set the county rates. The effective rates for FY 1999 are shown below:



FUEL TAX RATES PER GALLON ¹

	State	County	Total
GASOLINE AND DIESEL OIL (HWY. USE):²			
City & County of Honolulu	16.0¢	16.5¢	32.5¢
County of Maui	16.0¢	13.0¢	29.0¢
County of Hawaii	16.0¢	8.8¢	24.8¢
County of Kauai	16.0¢	10.0¢	26.0¢
LIQUID PETROLEUM GAS (HWY. USE):			
City & County of Honolulu	11.0¢	11.0¢	22.0¢
County of Maui ³	11.0¢	9.0¢	20.0¢
County of Hawaii	11.0¢	6.0¢	17.0¢
County of Kauai	11.0¢	7.0¢	18.0¢
ENVIRONMENTAL RESPONSE TAX (per barrel)⁴			
All Counties	5.0¢	--	5.0¢

¹Gasoline used for agricultural equipment off highways, aviation fuel, and all other fuels used off highways are taxed by the state at 1¢ per gallon.

²Includes 1¢ state license tax on diesel oil.

³Maui County tax rates effective August 1, 1995.

⁴Effective July 1, 1993.

PUBLIC SERVICE COMPANY TAXES

Public utilities and motor carrier-contact carriers paid public service company taxes totaling \$121.1 million in FY 1999, a slight increase of 0.7%, from \$120.3 million. Collections from public utilities dropped \$6.3 million from \$100.0 million to \$93.7 million, while revenues from motor carriers-contract carriers rose \$7.5 million from \$19.6 million to \$27.1 million.

PUBLIC SERVICE COMPANY TAXES (In Thousands of Dollars)

	FY 1999	FY 1998	Difference	
			Amount	%
Public Service Company Taxes	\$ 120,832	\$ 119,651	\$ 1,181	1.0
Penalty & Interest	311	675	-364	-49.2
TOTAL	<u>\$ 121,143</u>	<u>\$ 120,326</u>	<u>\$ 817</u>	<u>0.7</u>

NOTE: Due to rounding detail may not add to totals.

ESTATE AND TRANSFER TAXES

During FY 1999, a total of 1,912 estates were settled, down 10.5% from the 2,137 settled in FY 1998. The number of taxable estates increased from 398 in the previous year to 442 for this fiscal year. Estate tax collections totaled \$28.7 million, compared to \$19.6 million the year before.

Estates of persons who passed away before June 30, 1983 were subject to the inheritance tax. After that date, only those estates subject to the federal estate tax are subject to the Hawaii estate tax.

ESTATE AND TRANSFER TAXES (In Thousands of Dollars)

	FY 1999	FY 1998	Difference	
			Amount	%
Estate Tax	\$ 28,194	\$ 18,859	\$ 9,336	49.5
Penalty & Interest	544	787	-243	-30.8
TOTAL	<u>\$ 28,738</u>	<u>\$ 19,645</u>	<u>\$ 9,093</u>	<u>46.3</u>

NOTE: Due to rounding detail may not add to totals.

OTHER TAXES

Total revenues from other miscellaneous taxes fell 3.9%, from \$312.5 million to \$300.2 million. Franchise tax collected from banks and other financial corporations dropped 37.1%, or \$5.8 million. The conveyance tax is imposed at a rate of 10 cents per \$100 of the actual consideration paid for the transfer of ownership or interest in real property, and is collected by the Department of Land and Natural Resources. Indicative of an increase in real estate activity, conveyance tax collections grew 11.1%, representing an increase for each of the past three years, after several years of declines. The distribution of conveyance tax collections was one-half to the general fund, and one-fourth each to the state rental housing fund and the state natural area reserve fund. Act 170, SLH 1998, states that for FY 1999 only, the state rental housing fund be reduced from 25% to 12½%, and \$600,000 be appropriated out of the general fund for homeless assistance programs.

Effective July 1, 1998, the tax on cigarette was raised to 5¢; in FY 1998, the rate was increased from 3¢ to 4¢ on September 1, 1997. As a result tobacco tax collections jumped by 17.1%, or \$6.2 million, to \$42.3 million. Employment security contributions and insurance premium taxes each fell by more than \$6 million. Part of the drop in insurance premiums may be due to the change in filing due dates from monthly to quarterly periods. Despite an increase in liquor tax rates, liquor tax collections dropped slightly by 1.0%.

MISCELLANEOUS TAXES (In Thousands of Dollars)

	FY 1999	FY 1998	Difference	
			Amount	%
Banks & Other Financial Corporations	\$ 9,772	\$ 15,546	\$ -5,774	-37.1
Conveyance*	7,693	6,926	767	11.1
Empl. Security Contributions	148,951	155,062	-6,111	-3.9
Insurance Premiums	52,493	59,443	-6,950	-11.7
Liquor & Permits	38,508	38,894	-386	-1.0
Tobacco & Licenses	42,281	36,098	6,184	17.1
General Excise Licenses & Fees	542	552	-10	-1.9
TOTAL	\$ 300,240	\$ 312,520	\$ -12,280	-3.9

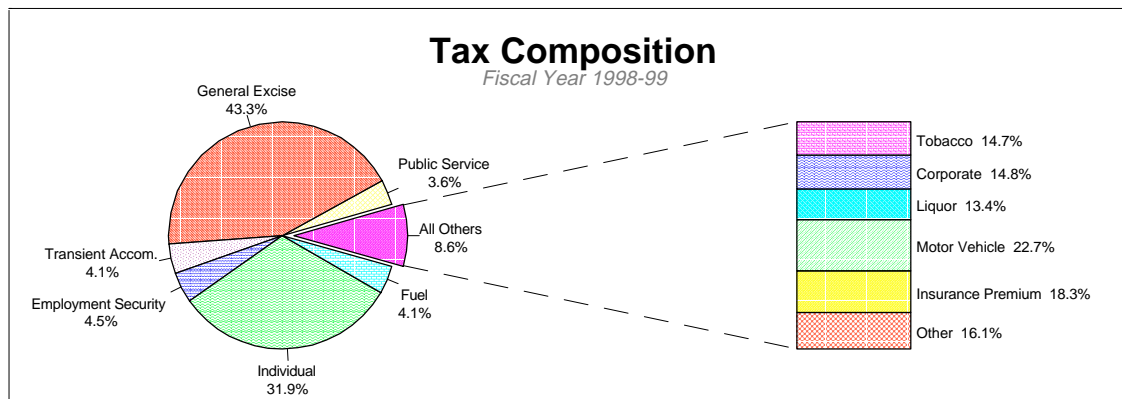
NOTE: Due to rounding detail may not add to totals.

*Includes allocation to "Rental Housing Fund" and "Natural Area Reserve Fund".

COLLECTION AND ACCOUNTING OF TAXES

TAX COLLECTIONS

Net tax collections amounted to \$3,346.7 million, 0.4% or \$12.4 million, more than the previous year. While the Department of Taxation collected most of these taxes, conveyance taxes of \$7.7 million were collected by the Department of Land and Natural Resources, insurance taxes of \$52.5 million by the Department of Commerce and Consumer Affairs, and state motor vehicle weight taxes and registration fees of \$65.4 million by the counties.



TAX COLLECTIONS

SOURCE OF REVENUE	FY 1999		FY 1998	
	Amount Collected	% of Total	Amount Collected	% of Total
Banks - Financial Corporations	\$ 9,771,609	0.29	\$ 15,545,923	0.47
Conveyance	7,692,700	0.23	6,925,845	0.21
Employment Security Contributions . .	148,951,137	4.45	155,062,026	4.65
Fuel	136,015,935	4.06	135,986,491	4.08
General Excise & Use	1,447,278,287	43.25	1,425,351,609	42.75
Income - Corporations	42,642,848	1.27	46,209,211	1.39
Income - Individuals	1,068,710,952	31.93	1,083,650,828	32.50
Inheritance and Estate	28,738,494	0.86	19,645,452	0.59
Insurance Premiums	52,493,166	1.57	59,442,790	1.78
Liquor & Permits	38,507,858	1.15	38,893,767	1.17
Motor Vehicle Tax*	65,354,478	1.95	63,548,765	1.91
Public Service Companies	121,142,774	3.62	120,326,236	3.61
Tobacco & Licenses	42,281,435	1.26	36,097,674	1.08
Trans. Accom. Fees	7,715	0.00	5,265	0.00
Trans. Accom. Tax	136,533,275	4.08	127,075,888	3.81
All Others	568,609	0.02	538,058	0.02
TOTAL	<u>\$ 3,346,691,270</u>	<u>100.00</u>	<u>\$ 3,334,305,828</u>	<u>100.00</u>

NOTE: Due to rounding detail may not add to totals.

* Includes Motor Vehicle Weight Tax, Registration Fees, Commercial Driver's License, Periodic Motor Vehicle Inspection, Rental Motor Vehicle Registration Fees, and Rental Vehicle Surcharge Tax.

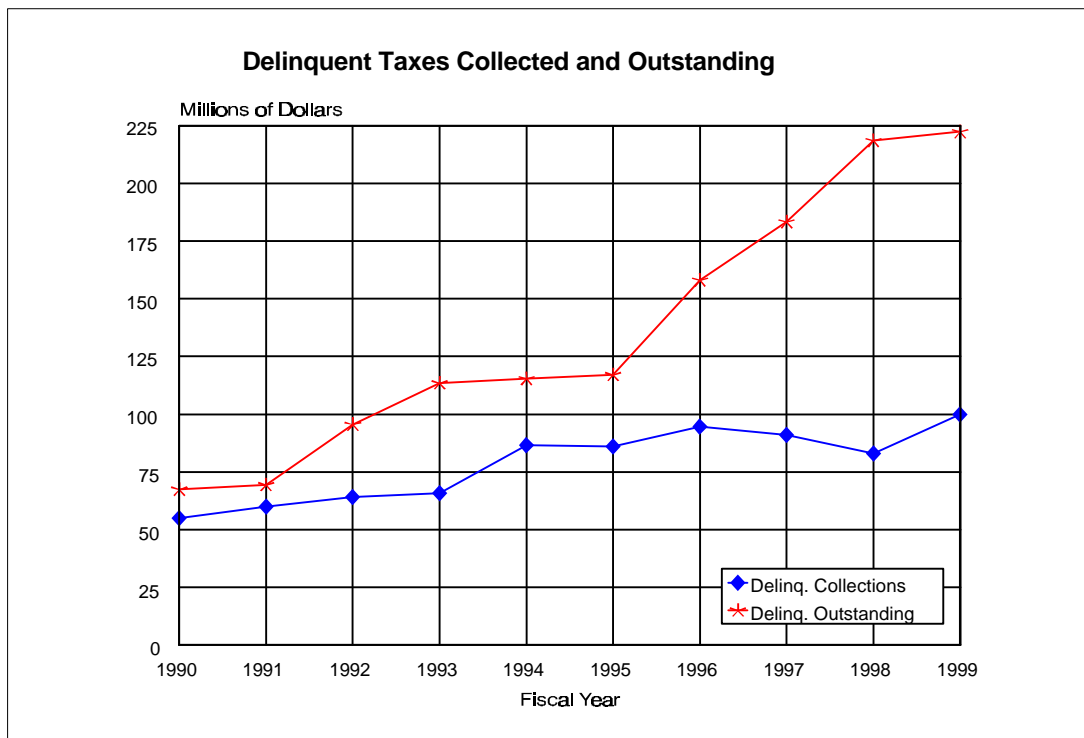
Approximately 85%, or \$2,854.2 million, of the \$3,346.7 million taxes collected was deposited into the state general fund. The counties received 4.3% or \$142.2 million, from fuel and transient accommodations tax revenues. The remaining \$350.3 million was distributed to eleven special funds. The largest amount in terms of dollar volume was placed in the unemployment trust fund (\$149.0 million), followed by \$134.1 million to the state highway fund, \$29.0 million to the tourism special fund, and \$23.2 million to the Convention Center fund. In FY 1998 half of the conveyance tax collection was deposited into the state general fund, while the other half was transferred into both the rental housing fund and the natural area reserve fund, each receiving one-fourth of this total. For FY 1999, the rental housing fund was reduced by half to one-eighth of the total, while \$600,000 was directed to homeless assistance programs. Also, transferred from the general fund is \$5 million to the bond reserve fund. Election campaign fund monies is designated by taxpayers who indicate so on their individual income tax returns.

Of the \$3.3 billion of taxes collected, cash collected from delinquent taxes amounted to \$99.8 million, up \$16.9 million over the previous fiscal year. Outstanding delinquent taxes for FY 1999 totaled \$222.3 million, \$3.9 million more than last fiscal year.

DISTRIBUTION OF COLLECTIONS

STATE FUNDS	FY 1999		FY 1998	
	Amount Collected	% of Total	Amount Collected	% of Total
State General	\$ 2,854,164,988	85.28	\$ 2,849,184,230	85.45
State Highway	134,134,384	4.01	132,335,385	3.97
State Airport	3,755,773	0.11	3,514,701	0.11
Boating Special Fund	1,304,951	0.04	1,307,754	0.04
Environmental Fund	1,765,102	0.05	1,696,415	0.05
Bond Reserve Fund	5,000,000	0.15	5,000,000	0.15
Unemployment Trust	148,951,137	4.45	155,062,026	4.65
Election Campaign Fund	260,596	0.01	280,334	0.01
Tourism Special Fund	29,049,237	0.87	0	0.00
Rental Housing Fund	982,945	0.03	1,731,461	0.05
Natural Area Reserve Fund	1,923,175	0.06	1,731,461	0.05
Convention Center Fund	23,240,977	0.69	21,179,315	0.64
Subtotal - State	<u>\$ 3,204,533,264</u>	<u>95.75</u>	<u>\$ 3,173,023,082</u>	<u>95.16</u>
REVENUES TRANSFERRED TO COUNTIES				
Fuel	60,410,204	1.81	60,681,001	1.82
Trans. Accom. Tax	<u>81,747,802</u>	<u>2.44</u>	<u>100,601,745</u>	<u>3.02</u>
Subtotal - Counties	<u>\$ 142,158,006</u>	<u>4.25</u>	<u>\$ 161,282,746</u>	<u>4.84</u>
TOTAL	<u>\$ 3,346,691,270</u>	<u>100.00</u>	<u>\$ 3,334,305,828</u>	<u>100.00</u>

NOTE: Due to rounding detail may not add to totals.



BRIEF SUMMARY OF HAWAII'S TAX SYSTEM

Two notable characteristics of Hawaii's tax structure are the high degree of centralization at the state level and the broad-based nature of its primary revenue source, the general excise tax. Hawaii's general excise tax is imposed on most sales of goods and services. Some transactions are exempted because they are subject to other taxes or because the legislature wished to encourage certain economic activities.

Qualified residents may claim several different tax credits. Among the most common credits claimed by Hawaii residents are the food, renter's, dependent care, energy, and capital goods excise tax credits. The \$27 per qualifying exemption food credit expired after tax year 1998. Effective with the 1999 tax year, a low income tax credit will be offered to taxpayers with AGI under \$20,000. Taxpayers with AGI under \$30,000 and annual rent payments of \$1,000 or more may claim a \$50 credit per exemption (plus an extra exemption for elderly taxpayers). Taxpayers may also claim a credit for dependent care, energy device purchase and installation, and capital goods excise. The mandated general income tax credit was not available this year because general fund year-end balances did not exceed 5% of general fund revenues for two successive fiscal years.

Hawaii has seventeen separate tax laws, of which fourteen are administered by the state. The remaining three -- real property tax, motor vehicle weight tax, and public utility franchise tax -- are administered by the counties. Until July 1, 1981, the real property tax law was administered by the state, with revenue from this source accruing to the counties. At present, the counties administer all of the real property functions. Administration of the state and county motor vehicle weight taxes is vested in the counties with the revenue accruing to the state and county highway funds.

Revenues from eleven of the state-administered taxes go into the state's general fund and are used to provide government services, including public education, which is a state function in Hawaii. Although the fuel tax is administered by the state, it is a source of revenue for both the state and county highway funds. The employment security tax is a dedicated tax used exclusively to provide benefits to cover unemployed workers. Rental motor vehicle and tour vehicle surcharge taxes are deposited into the state highway fund.

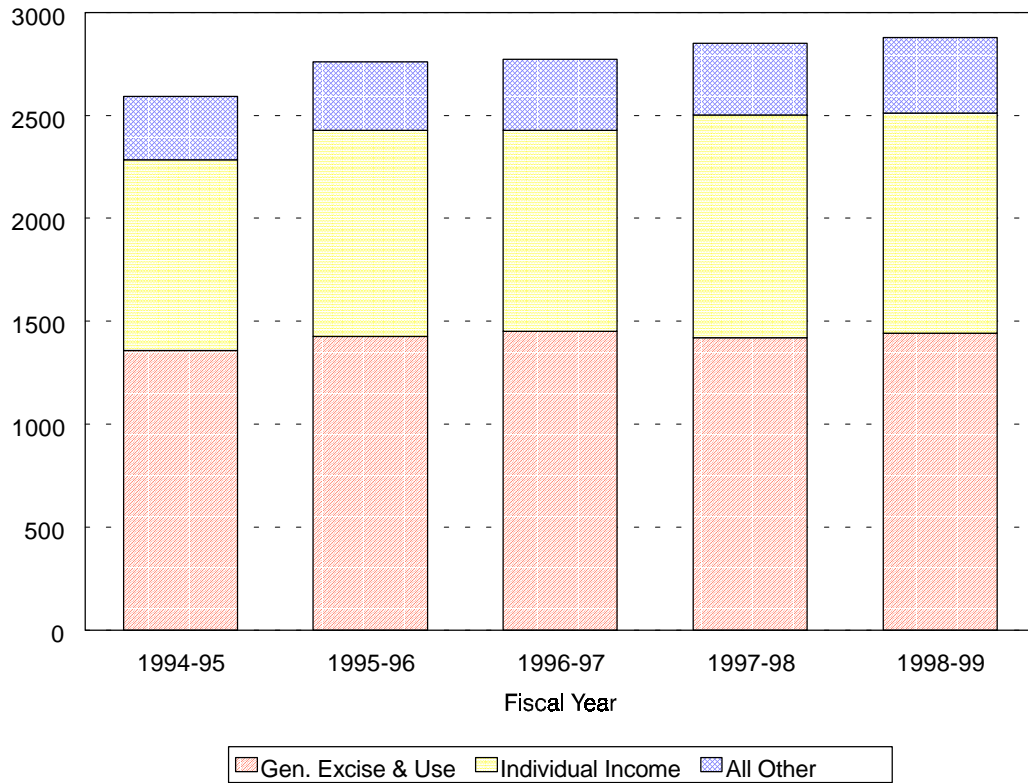
STATE GENERAL FUND

SOURCE OF REVENUE	FY 1999		FY 1998	
	Amount Collected	% of Total	Amount Collected	% of Total
Banks - Financial Corporations	\$ 9,771,609	0.34	\$ 15,545,923	0.55
Conveyance	4,786,580	0.17	3,462,922	0.12
General Excise & Use	1,442,278,287	50.53	1,420,351,609	49.85
Income - Corporations	42,642,848	1.49	46,209,210	1.62
Income - Individuals	1,068,450,356	37.43	1,083,370,494	38.02
Inheritance & Estate	28,738,494	1.01	19,645,452	0.69
Insurance Premiums	52,493,166	1.84	59,442,790	2.09
Liquor & Licenses	38,507,858	1.35	38,893,767	1.37
Public Service Companies	121,142,774	4.24	120,326,236	4.22
Tobacco & Licenses	42,281,435	1.48	36,097,674	1.27
Trans. Accom. Fees	7,715	0.00	5,265	0.00
Trans. Accom. Tax	2,495,259	0.09	5,294,829	0.19
All Others	568,609	0.02	538,058	0.02
TOTAL	<u>\$ 2,854,164,988</u>	<u>100.00</u>	<u>\$ 2,849,184,229</u>	<u>100.00</u>

NOTE: Due to rounding detail may not add to totals.

Trends in General Fund Tax Revenue

Millions of Dollars



OUTLINE OF THE HAWAII TAX SYSTEM AS OF JULY 1, 1999

Issued by the Department of Taxation

KIND OF TAX & LEGAL REFERENCES (HAWAII REVISED STATUTES)	MEASURE AND RATE OF TAX	REPORTS	TAX PAYABLE
<p>(1) Net Income</p> <p>Chapter 235 — Section 235-1 to 235-130</p>	<p>Act 157, SLH 1998, reduces the income tax rates and phases them in over a 4-year period. For taxable years beginning after December 31, 1998 (and before January 1, 2001), the tax rates for individuals as well as estates and trusts range from 1.6% to 8.75% of taxable income. The allowable standard deduction amounts vary by filing status. The standard deduction amount for married filing joint return or surviving spouse with dependent child is \$1,900; single is \$1,500; head of household is \$1,650; and married filing separately is \$950. Tax rates for corporations are 4.4% up to \$25,000, 5.4% over \$25,000 but not over \$100,000, and 6.4% over \$100,000.</p>	<p>Returns due 20th day of 4th month following the close of taxable year. Withholding returns due monthly on or before the 15th day of the following calendar month. When the total tax liability is less than \$1,000 for the calendar year, returns may be filed quarterly on or before the 15th day of the month after the close of each quarter. For employers whose liability for taxes withheld exceeds \$100,000 a year, withholding returns due monthly on or before the 10th day of the following calendar month. An annual employer's return and reconciliation of Hawaii income tax withheld, Form HW-3, must be filed together with a duplicate copy of each employee's tax statement, Form HW-2, on or before the last day of February following the close of the calendar year. Estimates of income of individuals not subject to withholding, estates, trusts, and corporations, April 20th.</p>	<p>In general, at time of filing returns. Estimates of individuals, estates, trusts, and corporations, one-quarter, April 20th; June 20th; September 20th; and January 20th.</p>
<p>(2) Estate and Transfer (for decedents dying after 6/30/83)</p> <p>Chapter 236D — Section 236D-1 to 236D-18</p>	<p>Every resident decedent is taxed on transfer of taxable estate equal to federal credit for estate death taxes allowed by IRC section 2011. Credit is allowed for death tax imposed by another state not qualified by reciprocal provision. For nonresident decedent, tax is based on transfer of taxable estate located in Hawaii by use of ratio. Exemption afforded resident estate equally applicable to nonresident, with certain exceptions.</p> <p>For generation-skipping transfers after June 30, 1994, a tax in an amount equal to the federal credit is imposed on every generation-skipping transfer of (1) property located in Hawaii and (2) property from a resident trust.</p>	<p>Report (Form M-6) must be filed by person responsible for filing federal Estate Tax Return (federal Form 706). No report required and no tax due when federal Form 706 not required. To obtain release of property, file Request for Release (Form M-6A).</p> <p>Report (Form M-6GS) must be filed by person responsible for filing Generation-Skipping Transfer Tax Return for Distributions (federal Form 706GS(D)) or Generation-Skipping Transfer Tax Return for Terminations (federal Form 706GS(T)).</p>	<p>On or before the due date for filing federal Form 706, including extensions of time; provided extension is submitted to Hawaii within 30 days of issuance.</p> <p>On or before the due date for filing federal Form 706GS(D) or 706GS(T), including extensions of time; provided extension is submitted to Hawaii within 30 days of issuance.</p>
<p>(3) General Excise (Gross Income)</p> <p>Chapter 237 — Section 237-1 to 237-49</p>	<p>This is a business privilege tax measured by gross proceeds of sales or gross income. The tax rate is 1/2 of 1% on wholesaling and intermediary services, producing, manufacturing, sugar processing and pineapple canning; all other activities (retailing business and professional services, contracting, theatre, amusement, radio, interest, commissions, rentals) are taxed at 4%, except insurance commissions received by general agents, subagents and solicitors who are taxed at .15%. The licensing fee for general excise tax licensees and nonprofit organizations is a one-time fee of \$20.</p>	<p>Monthly returns are due on or before the last day of the following month. When the total tax liability does not exceed \$2,000 for the calendar or fiscal year, returns may be filed quarterly on or before the last day of the month after the close of each quarter. When the total tax liability does not exceed \$1,000 for the calendar or fiscal year, returns may be filed semiannually on or before the last day of the month after the close of each semiannual period. An annual summary and reconciliation return must be filed on or before the 20th day of the 4th month following the close of the taxable year.</p>	<p>At time of filing returns.</p>
<p>(4) Transient Accommodations Tax</p> <p>Chapter 237D — Section 237D-1 to 237D-16</p>	<p>This is a tax levied on the furnishing of a room, apartment, suite, or the like which is customarily occupied by the transient for less than 180 consecutive days for each letting by a hotel, apartment, motel, horizontal property regime or cooperative apartment, rooming house, or other place in which lodgings are regularly furnished to transients for consideration. The tax is imposed at the rate of 7.25%. The registration fee for transient accommodations operators is a one-time fee of \$5 for each registration consisting of 1 to 5 units and \$15 for 6 or more units. Effective January 1, 1999, the transient accommodations tax of 7.25% is imposed on the fair market rental value of time share vacation units.</p>	<p>Monthly returns are due on or before the last day of the following month. When the total tax liability does not exceed \$2,000 for the calendar or fiscal year, returns may be filed quarterly on or before the last day of the month after the close of each quarter. When the total tax liability does not exceed \$1,000 for the calendar or fiscal year, returns may be filed semiannually on or before the last day of the month after the close of each semiannual period. An annual summary and reconciliation return must be filed on or before the 20th day of the 4th month following the close of the taxable year.</p>	<p>At time of filing returns.</p>

KIND OF TAX & LEGAL REFERENCES (HAWAII REVISED STATUTES)	MEASURE AND RATE OF TAX	REPORTS	TAX PAYABLE
(5) Use Chapter 238 — Section 238-1 to 238-16	This is an excise tax levied on tangible personal property which is imported or purchased from an unlicensed seller for use in the State. The tax is based upon the purchase price or value of the tangible personal property purchased or imported, whichever is applicable. Rates: 1/2 of 1%, if for resale at retail; 4%, if for use or consumption. For exceptions, see sections 238-3 and 238-4. Act 70, SLH 1999, imposes the use tax on the value of services that are performed by an unlicensed seller at a point outside the State and imported or purchased for use in the State, effective for use taxes accruing after December 31, 1999.	Monthly returns are due on or before the last day of the following month. When the total tax liability does not exceed \$2,000 for the calendar or fiscal year, returns may be filed quarterly on or before the last day of the month after the close of each quarter. An annual summary and reconciliation return must be filed on or before the 20th day of the 4th month following the close of the taxable year. These returns have been consolidated with the general excise (gross income) tax returns and are filed simultaneously.	At time of filing returns.
(6) Public Service Company Chapter 239 — Section 239-1 to 239-11	Nature of Tax—(1) Public utility business in lieu of general excise and real property taxes. (a) Measurement of assessment—general rule: Gross income from public utility business of public utilities for preceding calendar year. For exception, see section 239-9. (b) Rates: (i) Gross income from passenger fares for transportation between points on a scheduled route by a carrier of passengers, 5.35%. (ii) Sale of its products or services to another public utility which resells such products or services, 1/2 of 1%. (iii) All other revenues: If ratio of net to gross income is 15% or less, 5.885%; for each 1% increase in ratio of net to gross, rate increase .2675%. (2) Motor carrier, common carrier by water and contract carrier business (other than motor carrier business) in lieu of general excise tax. (a) Measurement of assessment—general rule: Gross income from motor carrier, common carrier by water and contract carrier business for preceding calendar year. For exception, see sections 239-9 and 239-11. (b) Rate: 4% of gross income.	Returns filed on or before the 20th day of the 4th month following the close of the taxable year, based upon operations of the preceding taxable year.	First installment at the time of filing return, or, on or before the 20th day of the 4th month. Other installments due on the 20th day of the 2nd, 5th, and 8th month thereafter. If the total tax liability for the taxable year exceeds \$100,000, 1st installment on or before the 10th day of the 1st month. Remaining installments due on or before the 10th day of each calendar month thereafter.
(7) Banks, Building and Loan, Financial Services Loan Companies and Certain Other Financial Corporations Chapter 241 — Section 241-1 to 241-7	(1)(a) Assessment Date: January 1. (b) Nature of Tax: a franchise tax (in lieu of net income and general excise taxes) on banks, building and loan associations, development companies, financial corporations, financial services loan companies, trust companies, mortgage loan companies, financial holding companies, small business investment companies, or subsidiaries not subject to the tax imposed by chapter 235. (2) Measure of Assessment: Net income for the preceding year from all sources as defined by chapter 235 (Income Tax Law) with modifications. (3) Rate: 7.92% of taxable income.	Returns filed on or before the 20th day of the 4th month following the close of the taxable year, based upon operations of the preceding taxable year.	First installment at the time of filing return, or, on or before the 20th day of the 4th month. Other installments due on the 20th day of the 2nd, 5th and 8th month thereafter. If the total tax liability for the taxable year exceeds \$100,000, 1st installment on or before the 10th day of the 1st month. Remaining installments due on or before the 10th day of each calendar month thereafter.

KIND OF TAX & LEGAL REFERENCES (HAWAII REVISED STATUTES)	MEASURE AND RATE OF TAX	REPORTS	TAX PAYABLE
(8) Fuel Chapter 243 — Section 243-1 to 243-16	Distributors, as defined, are required to pay: 1¢ per gallon on aviation fuel; an initial 1¢ per gallon on diesel oil, liquefied petroleum gas for operation of an internal combustion engine and from 24.8¢ to 32.5¢ per gallon on liquid fuels other than the foregoing; also, pay additional taxes from 24.8¢ to 32.5¢ per gallon on diesel oil and from 17¢ to 22¢ per gallon on liquefied petroleum gas used to operate motor vehicles upon the public highways, however, they are not required to pay these additional taxes if purchasers furnish Exemption Certificates, Form M-38. Refunds of liquid fuel used for agricultural equipment not operated upon the public highways or diesel oil and liquefied petroleum gas used for motor vehicles not operated upon the public highways may be claimed on Form M-36. Distributors are required to register and be licensed. Licenses are valid until revoked. An Environmental Response Tax of 5¢ per barrel or a fractional part of a barrel of petroleum product sold by a distributor to a retail dealer or end user is also imposed.	Returns are due monthly on or before the last day of the following month.	At time of filing returns.
(9) Liquor Chapter 244D — Section 244D-1 to 244D-17	This is a gallonage tax imposed upon “dealers” as defined in the law and certain others who sell or use liquor. A \$2.50 liquor tax permit is required and must be renewed before July 1st of each year. See section 244D-4 for exemption from tax. For the period beginning July 1, 1998, and thereafter, the tax rates per wine gallon are \$5.98 on distilled spirits, \$2.12 on sparkling wine, \$1.38 on still wine, \$.85 on cooler beverages, \$.93 on beer other than draft beer, and \$.54 on draft beer.	Returns filed on or before the last day of the following calendar month.	At time of filing returns.
(10) Cigarette and Tobacco Chapter 245 — Section 245-1 to 245-15	“Wholesalers” and “dealers” as defined in the law must pay an excise tax on sale or use of tobacco products equal to 40% of the wholesale price and a fixed tax rate of 5¢ on each cigarette sold, used, or possessed. A \$2.50 tobacco tax license is required and must be renewed before July 1st of each year.	Returns filed on or before the last day of the following calendar month.	At time of filing returns.
(11) Conveyance Chapter 247 — Section 247-1 to 247-13	This tax is imposed on all documents transferring ownership or interest in real property. The rate is 10¢ per \$100 of the actual and full consideration paid or to be paid. Minimum \$1 tax for each taxable transaction. (Documents of certain conveyances are exempted.)	A certificate of conveyance must be filed with the document at the Bureau of Conveyances within 90 days after a taxable transaction; a claim for exemption from the conveyance tax must be filed for certain exempt conveyances.	At time of filing the certificate, but no later than 90 days after the taxable transaction.
(12) Rental Motor Vehicle and Tour Vehicle Surcharge Tax Chapter 251 — Section 251-1 to 251-15	There is a rental motor vehicle surcharge tax of \$2 a day or any portion of a day that a rental motor vehicle is rented or leased. The tax is levied on the lessor. There is also a tour vehicle surcharge tax of \$65 per month for each tour vehicle in the 25 passenger seat and over category and \$15 per month for each tour vehicle in the 8 to 25 passenger seat category. The tax is levied on the tour vehicle operator. There is a one-time \$20 registration fee. Act 223, SLH 1999, increases the rental motor vehicle surcharge tax from \$2 to \$3 for the period September 1, 1999, to August 31, 2007.	Monthly returns are due on or before the last day of the following month. When the total tax liability does not exceed \$2,000 for the calendar or fiscal year, returns may be filed quarterly on or before the last day of the month after the close of each quarter. When the total tax liability does not exceed \$1,000 for the calendar or fiscal year, returns may be filed semiannually on or before the last day of the month after the close of each semiannual period. An annual summary and reconciliation return must be filed on or before the 20th day of the 4th month following the close of the taxable year.	At time of filing returns.

KIND OF TAX & LEGAL REFERENCES (HAWAII REVISED STATUTES)	MEASURE AND RATE OF TAX	REPORTS	TAX PAYABLE
<p>(13) Unemployment Insurance</p> <p>Chapter 383 — Section 383-1 to 383-176</p>	<p>This is a tax on wages paid by employing units with 1 or more employees with certain exemptions. The unemployment tax rate is determined according to a multi-contribution schedule system. Each year, 1 of 8 contribution schedules is applicable depending on the condition of the UI Trust Fund. An employer's contribution rate is not less than 0.00% or greater than 5.40%.</p> <p>From January 1, 1999, through December 31, 2000, there is an additional 0.05% employment and training (E & T) fund assessment on taxable wages paid to an employee. The E & T assessment is applicable to all employing units with unemployment insurance contribution rates greater than 0.00% and less than 5.4%.</p> <p>There is a limitation of the tax on wages paid to an employee called the "tax base". The tax base is equal to the State's average annual wages of employers contributing to the UI trust fund and is computed at the beginning of each calendar year.</p>	<p>On a quarterly basis, employers submit Form UC-B6, "Quarterly Wage, Contribution and Employment and Training Assessment Report." The report must be filed on or before the last day of the month following the report quarter.</p>	<p>At time of filing returns.</p>
<p>(14) Insurance Premiums</p> <p>Chapter 431 — Section 431:7-201 to 431:7-207</p>	<p>Tax on insurance companies (Underwriters) based on premiums received in Hawaii. In lieu of all taxes except property tax and taxes on the purchase, use or ownership of tangible personal property. Tax Rates: Life Insurance, 2.75%; Surplus Lines, 4.68%; Ocean Marine, .8775% on gross underwriting profit; and Other Insurance, 4.265%. To insurers who qualify, there is a 1% tax credit to facilitate regulatory oversight. This law is administered and the tax collected by the Insurance Commissioner, who is required to report to the Director of Taxation all amounts of taxes collected under this chapter.</p>	<p>Quarterly tax statement is due on or before the last day of the calendar month following the quarter in which the tax accrued. Annual Tax Statement is due on or before March 1 with the Insurance Commissioner.</p>	<p>At time of filing statements.</p>

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